

## Credit Analysis

## The Gambia

### Ratings

#### Foreign Currency

Long-term.....	B-
Short-term.....	B

#### Local Currency

Long-term.....	B-
----------------	----

**Outlook** .....Stable

### Peer Group

B	Indonesia
	Turkey
	Ukraine
	Venezuela
B-	Lebanon
	<b>The Gambia</b>
CCC+	Ecuador

### Ratings History

Date	Ratings
11/2002	B-

### Analysts

Veronica Kalema  
+44 20 7417 6336  
veronica.kalema@fitchratings.com

James McCormack  
+44 20 7417 4348  
james.mccormack@fitchratings.com

### ■ Summary

The ratings reflect The Gambia's good external payment record and an improved outlook for the medium-term sustainability of its external debt burden as a result of debt relief under the enhanced heavily indebted poor country (HIPC) initiative. Qualification for HIPC was based on a satisfactory reform record. Strong donor support towards poverty reduction at a donor conference held in September further supports the ratings. Together with HIPC debt relief this will provide a reform anchor, ensuring that the overall direction of addressing formidable poverty and institutional and structural reform challenges will be positive.

The Gambia's reform record has nonetheless been mixed. The re-launch of reforms in 1998 delivered buoyant growth and inflation has remained low. However, operational and structural weaknesses have impeded a sustained improvement in public finances and domestic debt has continued to rise. Other structural reforms such as privatisation have stalled since 1999. The problems reflect one-off expenditures, which were arguably beyond the authorities' control, as well as incidences of outright policy reversal. Weak administrative and institutional capacity will continue to constrain the pace of reform. Relations with Senegal, which completely surrounds The Gambia, are especially important. Periodic border closures by Senegal, due to a variety of ongoing disputes, disrupts the important re-exports activity, affecting both the external and fiscal balances.

### ■ Credit Outlook

The Gambia has to meet a number of conditions which involve some of the reform areas that have proven difficult to implement in the past, to reach a 'floating' completion point when it is expected to receive the full total of USD67m in net present value (NPV) terms of debt relief. Implementation of these reforms will be crucial to maintain the current rating level, which factors in HIPC debt relief.

### ■ Strengths

- Relatively sound monetary and exchange rate policy
- Debt relief and reforms anchored by HIPC initiative
- Significant future aid flows as a result of the donor conference
- Low debt service and strong external liquidity
- Good external payment record

### ■ Weaknesses

- Fiscal slippage undermines public finances
- Weak public institutions and administrative capacity
- Narrow-based economy
- Weak infrastructure (particularly electricity)
- Significant poverty and social challenges
- Periodic border closures by Senegal disrupt re-exports trade

## Key Indicators for The Gambia

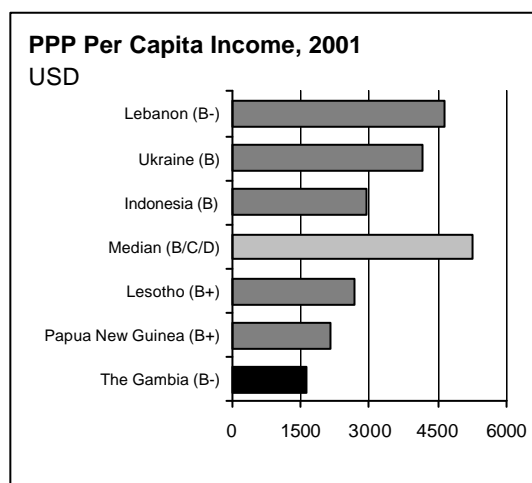
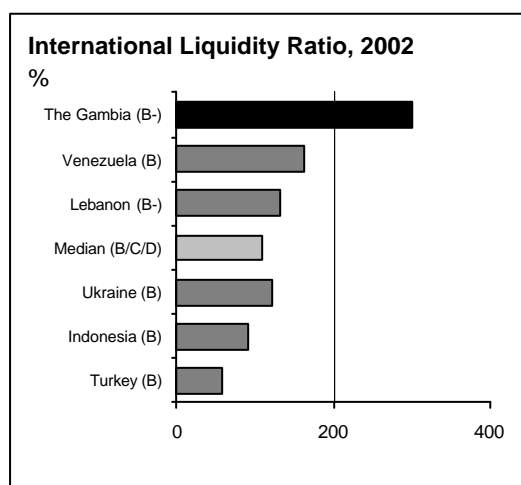
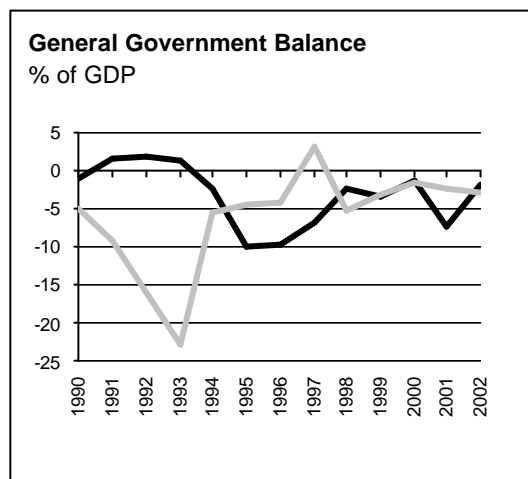
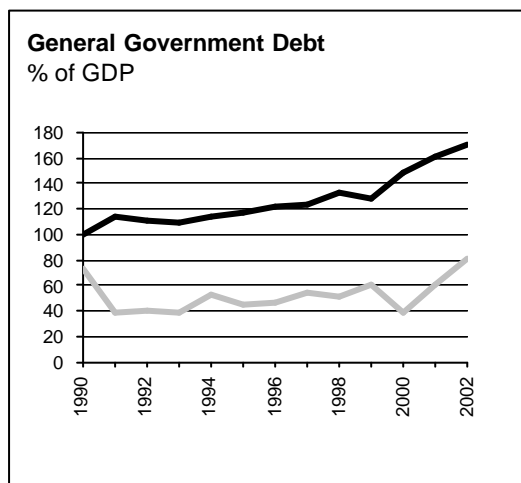
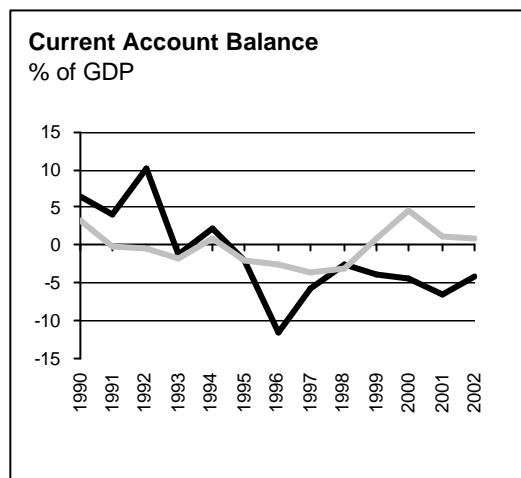
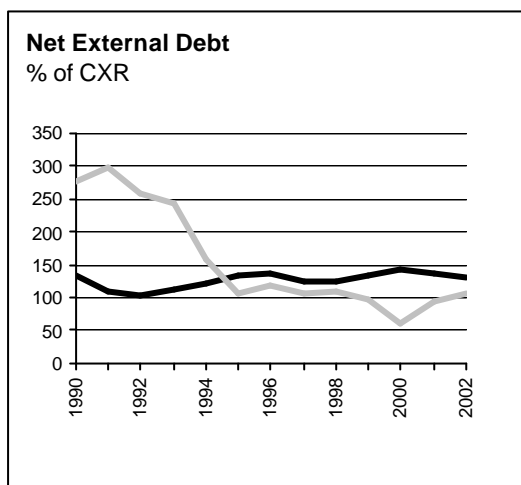
<b>Population (2001):</b> 1.42m	<b>Population Growth Rate : (1996-2001)</b> 4.3% p.a.						
<b>GDP (2001):</b> USD390.4m	<b>GDP Per Head at Market Exchange Rates (2001):</b> USD275						
<b>GNI Per Head at Purchasing Power Parity (2000):</b> USD1,620 (= 4.8% of USA level)							
<b>Modern Sovereign Rescheduling History:</b> 1986 Paris club rescheduling on non-concessional terms, 2000 HIPC debt relief							
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002<sup>f</sup></b>	<b>2003<sup>f</sup></b>
<b>Domestic Economy and Finance</b>							
Real GDP growth (%)	5.2	4.9	6.4	5.6	6.0	4.0	6.0
Consumer prices (annual average % change)	2.8	1.1	3.8	0.9	4.5	6.5	4.0
Gross domestic savings (% of GDP)	7.2	7.5	8.3	8.0	7.9	7.1	7.9
Gross domestic investment (% of GDP)	17.2	18.3	17.2	20.6	19.4	22.1	21.2
Short-term interest rate (%) <sup>(1)</sup>	16.0	14.0	12.5	12.0	15.0	15.5	15.0
Broad money (% change Dec to Dec)	23.0	10.2	12.1	34.8	19.4	13.2	9.9
GMD per USD (annual average)	10.2	10.6	11.4	12.8	15.7	18.5	21.3
REER <sup>(2)</sup> (CPI, 1995=100)	103.6	102.0	99.9	95.0	85.6	74.1	74.1
REER: % change (+ = appreciation)	4.6	-1.5	-2.1	-4.8	-9.9	-13.4	0.0
<b>Public Finances</b>							
General government balance (% of GDP)	-6.5	-2.4	-3.5	-1.4	-7.2	-2.3	-3.8
General government debt (% of GDP)	123.7	132.0	128.0	148.7	154.4	162.1	126.4
General government debt (% of revenue)	606.5	642.6	667.2	717.9	840.1	754.4	568.7
Interest payments (% of revenue)	25.2	25.7	26.3	23.7	26.7	24.0	22.5
<b>Balance of Payments</b>							
Current account balance (USDm)	-23.6	-11.4	-17.1	-18.6	-25.7	-15.3	-11.2
Current account balance (% of GDP)	-5.7	-2.7	-4.0	-4.4	-6.6	-4.1	-3.1
Current account balance <i>plus</i> net FDI (USDm)	-11.6	-2.4	-11.1	-16.6	-21.7	-13.3	-7.2
Current account balance <i>plus</i> net FDI (% of GDP)	-2.8	-0.6	-2.6	-3.9	-5.6	-3.5	-2.0
Gross financing requirement (% of official reserves) <sup>(2)</sup>	36.3	27.7	26.7	29.0	33.8	24.6	14.1
Current external receipts CXR (USDm)	277.7	300.1	283.7	270.9	291.0	305.8	332.5
Current external receipts CXR (annual % change)	6.4	8.1	-5.5	-4.5	7.4	5.1	8.7
Current external payments CXP (USDm)	301.3	311.5	300.8	289.5	316.6	321.1	343.7
Current external payments CXP (annual % change)	-2.4	3.4	-3.4	-3.7	9.4	1.4	7.1
<b>External Assets and Liabilities</b>							
Gross external debt (USDm)	449.8	487.1	501.2	504.6	522.8	527.4	444.5
Gross external debt (% of GDP)	109.8	115.8	116.0	119.7	133.9	140.7	124.0
Gross external debt (% of CXR)	162.0	162.3	176.7	186.3	179.7	172.5	133.7
Net external debt (USDm)	343.1	374.2	379.1	385.9	407.6	412.0	323.4
Net external debt (% of GDP)	83.7	88.9	87.8	91.5	104.4	110.0	90.2
Net external debt (% of CXR)	123.5	124.7	133.6	142.5	140.1	134.7	97.2
Public external debt (USDm)	412.2	443.9	442.0	443.3	456.4	458.4	369.5
Public external debt (% of GDP)	100.6	105.5	102.3	105.1	116.9	122.3	103.1
Net public external debt /CXR (%)	113.8	112.5	116.6	123.2	120.4	114.8	77.1
Public FC denominated & FC indexed debt (USDm)	412.2	443.9	442.0	443.3	456.4	458.4	369.5
Short-term external debt (% of gross external debt)	2.9	3.1	4.4	5.4	4.8	4.7	5.6
External debt service (% of CXR)	8.9	6.8	5.9	7.3	5.5	5.3	2.9
External interest service (% of CXR)	4.1	1.8	1.9	2.3	1.6	1.7	1.7
Liquidity ratio (%) <sup>(3)</sup>	223.6	317.6	353.4	291.6	272.8	280.2	333.4
Official international reserves including gold (USDm)	96.0	106.4	111.2	109.4	106.0	107.4	113.1
Official international reserves in months of CXP cover	3.8	4.1	4.4	4.5	4.0	4.0	3.9
Official international reserves (% of broad money)	85.0	89.1	87.4	82.2	75.8	84.1	82.5

(1) Treasury Bill rate

(2) Current account balance plus amortisation of medium and long-term debt, over official international reserves.

(3) Official reserves incl. gold *plus* banks' foreign assets/ Debt service *plus* liquid external liabilities.

## Peer Comparison



Source: Fitch Sovereign Comparator

The Gambia
  B/C/D Median

## ■ Rationale

Fitch Ratings has assigned a 'B-' Long-term foreign currency rating (LTFC) to The Gambia. The ratings reflect The Gambia's good external payment record and an improved outlook for the medium-term sustainability of its external debt burden as a result of debt relief under the enhanced heavily indebted poor country (HIPC) initiative.

Qualification for HIPC in December 2000 was based on a satisfactory reform record since reforms were re-launched in mid-1998. During the past four years, The Gambia has achieved average yearly growth of 5.5% and as a result of sound monetary policies, macroeconomic stability has been maintained. The Gambia has been successful at liberalising the external sector – bringing down tariffs without overly affecting customs revenue and introducing foreign currency deposit accounts – while banking reforms have strengthened an almost totally private and majority foreign-owned banking sector. Democracy has become entrenched following a second set of presidential and parliamentary elections late last year and early this year respectively, leading to the lifting of US sanctions. In recognition of these achievements and following the completion of a comprehensive and participatory poverty reduction strategy paper (PRSP), The Gambia received very strong donor support towards poverty reduction at a donor conference held in September.

Progress on other reform areas has been mixed and sometimes very weak. Although the overall direction towards fiscal consolidation has been positive since 1998, operational and structural weaknesses have impeded a sustained improvement in public finances and domestic debt has continued to rise. Other structural reforms such as privatisation have stalled since 1999. The problems reflect weak administrative and institutional capacity, one-off expenditures, which were arguably beyond the authorities' control, as well as incidences of outright policy reversal. In addition, periodic border closures by Senegal, which completely surrounds The Gambia, disrupts the important re-exports activity, affecting both the external and fiscal balances.

The Gambia has to meet a number of conditions, which involve some of the reform areas that have proven difficult to implement in the past, to reach a 'floating' completion point when it is expected to receive the full total of USD67m in net present value (NPV) terms of debt relief. Implementation of these reforms will be crucial to maintain the current rating level which factors in HIPC debt relief.

In the meantime, donor aid worth USD115m, pledged at a donor conference in September towards the PRSP (and far exceeding the government's target of USD70m) is viewed positively from a credit rating perspective. This aid is in addition to HIPC completion point debt relief. As well as boosting growth and contributing towards a smaller build up of new debt, it should support the implementation of the PRSP for one year – one of the triggers for completion point debt relief. The main other completion point triggers will lead to the restart of privatisation and to some progress on fiscal transparency and accountability. In view of formidable poverty and institutional and structural reform challenges, the role of foreign aid and debt relief as a reform anchor is positive for the rating.

The government's efforts to facilitate trade have been reasonably successful, for example tariffs were reduced to very low levels as far back as 2000, and since February it has been possible to open a foreign currency deposit account at three of the banks. The Trade Gateway project initiated this year will involve the development of free trade zones at Banjul seaport and airport for the processing and export of mainly fish, horticulture and agriculture products. The Gambia Tourist Agency was also established earlier this year to promote tourism. Prospects of joining the US Africa Growth and Opportunities Act (AGOA) initiative have improved following satisfactory elections and the resumption of good relations with the US. Notwithstanding high electricity costs, The Gambia's cheap labour is a source of advantage. Re-exports and other exports should benefit from a more competitive currency. Success in the above initiatives would diversify and expand The Gambia's export base, thereby improving its creditworthiness.

## Peer Comparator - 2001

%	The Gambia	B/C/D median
GXD/CXR	180	132
NXD/CXR	140	106
Debt service/CXR	5.5	23.9
External liquidity ratio	273	101
General gov't balance/GDP	-7.2	-3.6
General gov't debt/GDP	154	68
Consumer prices	4.5	10.5

Source:Fitch

The main other challenge is fiscal discipline so as to bring down domestic debt and help maintain macroeconomic stability. Expenditure control is particularly weak, and last year non-budgeted-for expenditure related to the elections and a one-off

payment for power generators contributed to a budget deficit, including grants, of 7.2% of GDP. Though revenue reforms have been generally more successful, customs revenue will continue to be adversely affected by the periodic tightening of Senegal's borders. Payment arrears between the government and public enterprises have yet to be netted out and cleared and the lack of transparency tends to undermine fiscal performance. Although at 33½% of GDP the level of domestic debt is not very high, it has been rising very fast and high interest costs absorb over 20% of government revenue, leaving few resources for much-needed social spending.

In addition, the local currency rating is adversely affected by the government's insufficient control over the issuance of treasury bills although it is responsible for their repayment. Treasury bills are issued by the Central Bank for both liquidity management and deficit financing. The local currency rating, which is usually higher than the foreign currency rating, reflecting mainly the absence of transfer risk for domestic debt repayments, is assigned at the same level as the foreign currency rating: 'B-'.

On reaching the completion point external debt ratios will be more or less in line with the 'B/B-' rating median with the net external debt (NXD): current account receipts (CXR) ratio falling to 97% from 140% in 2000-2001 and the gross external debt (GXD):CXR ratio declining to 134% from around 180% in 2000-2001. According to IMF calculations, The Gambia's public external debt on a net present value (NPV) basis (which takes into account the concessional nature of its debt) after HIPC debt relief would have been the equivalent of 41% of GDP at end 1999, which looks much more comfortable.

The Gambia is already benefiting from interim HIPC debt relief, which took effect at the decision point at the end of 2000, bringing its external debt service down to 5.5% in 2001 (from 7% in 2000), and it is expected to fall further to 3% on the completion point. External liquidity (foreign reserves plus banks' foreign assets/short-term liabilities) is expected to strengthen to around 330% in 2003 as a result of the large increase in donor aid. The Gambia was not in arrears prior to receiving debt relief. All these factors represent rating strengths.

## ■ Political & Social Situation

Two elections have legitimised the presidency of Yahyah Jameh, who took office following a coup d'état in 1994. Most important from a credit rating

view point is that improved democracy has led to the resumption of donor aid, which the country sorely needs for budgetary assistance and debt relief, as well as for social development.

The coup d'état led to years of international isolation. Following international pressure, a ban on political activity was lifted and presidential and legislative elections were held in 1996 and 1997, respectively. These helped improve donor relations and an IMF supported programme was launched in 1998. Relations with donors have improved further following elections in October 2001 (presidential) and January 2002 (parliamentary), which were judged by international observers to have been free and fair. The US government in March lifted sanctions which had been imposed in 1994 as a result of the coup d'état. The parliamentary elections were, however, boycotted by the main opposition party, weakening the democratic process. The executive was already very strong.

## Presidential Election results, 2001

	% of Votes
Yahyah Jameh (Alliance for Patriotic Reorientation and Construction)	52.96
Ousainou Darboe (United Democratic Party)	32.67
Hamat Bah (National Reconciliation Party)	7.80
Sheriff Dibba (National Convention Party)	3.78
Sidia Jatta (People's Democratic Organisation for Independence)	2.79
<b>Total</b>	<b>100.00</b>

Source: Independent Electoral Commission

## Parliamentary Elections results, 2002

	Parliamentary Seats
Alliance for Patriotic Reorientation and Construction	45
People's Democratic Organisation for Independence	3
Appointed members	5
<b>Total</b>	<b>53.0</b>

Economic necessity means that The Gambia will maintain relatively good relations with donors. At a donor conference held in September, The Gambia received pledges worth USD115m over the next three years to go towards supporting its poverty reduction strategy paper (PRSP). This by far exceeded the government's target of USD70m. Strong donor support takes account of The Gambia's thorough and participatory PRSP which has as its main facets an enabling macro economic framework to deliver 6% growth, social spending on education and health, increased agriculture support, development of the private sector through

The Gambia

the expansion of infrastructure and improved access to credit for small and medium-sized enterprises and the rural population. In the PRSP the government acknowledged that poverty had doubled over the past decade, with poverty predominantly in rural areas, although it has begun to accelerate in urban areas, reflecting rapid demographic growth mainly from neighbouring countries under conflict. Rural poverty has risen because of erratic agricultural output owing to climatic change and the problems with groundnuts pre-financing, processing and marketing. Social spending *per capita* has not kept up with the demographic expansion.

## ■ Short-term Prospects

Economic growth this year will be affected by untimely rain which hit the groundnut crop and other food crops. This is expected to slow growth to around 4%. In 2003 the economy should start to reap some of the benefits of its recent structural initiatives, such as the establishment of duty free trade zones and increased spending on the PRSP, and as a result growth is forecast to pick up to 5% - 6% per annum. High levels of donor aid inflows over the next three years should support the currency – the dalasi (GMD) – and help deliver low inflation provided that budgetary discipline is maintained. The performance of the external sector should improve over the medium term, reflecting an expected recovery in tourism receipts and other exports, higher official transfers and debt relief.

## Economic Performance and Outlook

	2001	2002f	2003f
Real GDP (%)	6.0	4.0	6.0
CPI inflation (% annual avg.)	4.5	6.5	4.0
Budget balance (% GDP)	-7.2	-2.3	-3.8
Current account (% GDP)	-6.6	-4.1	-3.1

## ■ Economic Fundamentals

The Gambia is a small open economy. The country is completely surrounded by Senegal. However, the geographical location of the Banjul port and access inland from the port via the Gambia river, have long made The Gambia a regional trading post, supplying re-exported foreign goods to neighbouring countries – Senegal, Mali, Guinea and Sierra Leone. Re-export activities currently account for 30% of GDP and generate over 50% of The Gambia's foreign exchange earnings. Most of the re-exports trade is in the informal sector. The Gambia has so far managed to remain competitive, by lowering its tariffs in response to a tariff

reduction in the West African CFA<sup>1</sup> franc zone countries, and owing to the greater efficiency of its ports compared to neighbouring countries. The periodic tightening of border controls by Senegal will continue to create difficulties for the re-exports business. However, given the importance of this activity to The Gambian economy, the government is likely to counter any tariff reductions or currency devaluations by the CFA zone with lower tariffs, although this is likely to have an adverse effect on customs revenue.

Agriculture – subsistence and groundnut production (accounting for 10% of GDP) – and tourism are the other main areas of economic activity and the latter two are the main foreign exchange earners outside the re-exports sector. Agriculture is the largest employer in the economy – with an estimated 75% of the adult population engaged in farming. The resolution of the Alimenta dispute (see below), which has paved the way for the resale of the Gambia Groundnut Corporation (GGC), should help the marketing and processing of groundnuts, improving prospects for the sector. Fishing, another export earner, will benefit from the expansion of processing facilities. Tourism (mainly charter holiday tourists) is also expected to recover following the elections, which were conducted smoothly.

The Gambia's production base is limited reflecting the small size of its domestic market, access to cheap imported goods and poor electricity infrastructure, which is unreliable and costly as it uses fuel oil.

Given this situation, the government is encouraging investment in services and agriculture exports (including processed exports) in areas such as fishing, horticulture and tourism, as a way of diversifying and increasing foreign exchange earnings. The Gambia's Trade Gateway project launched in February (with World Bank support) will provide duty free trade zones at the Banjul seaport and the Banjul Yundum International Airport for this purpose. The possibility of joining the US Africa Growth and Opportunity Act (AGOA) initiative, which provides duty and quota free access of textiles and other labour-intensive products to the US market, following satisfactory elections and resumption of good relations with the US, will support the government's efforts to encourage investment into the export sector. The Gambia's cheap labour is a source of advantage.

<sup>1</sup> stands for Communauté Financière Africaine

However, poor electricity infrastructure will remain a bottleneck.

Progress on privatisation stalled in 1994<sup>2</sup>. Furthermore the privatisation effort received a large set back when in early 1999 the Gambia Groundnut Corporation (GGC), which is involved in the pre-financing, marketing and processing of groundnuts, was expropriated from Alimenta (Swiss-owned). Since 1999 when a hotel and Trust Bank were sold, there have been no privatisations. However, the government in 2001 provided Alimenta with a USD11.4m settlement, which has helped to restore some investor confidence, and with the formation of a divestiture agency in March 2001, the privatisation programme is expected to restart in 2003. The first priority (and a HIPC debt relief completion point condition) will be the resale of the GGC. Easier sales, such as those of the governments' stakes in majority foreign-owned companies, are scheduled to occur in the short term. The privatisation of utilities is more of a medium-term aim, as legal frameworks for privatisation and regulation need to be provided. Some of the proceeds will be used to pay down domestic debt.

The Gambia resumed relations with the IMF in June 1998 under an Enhanced Structural Adjustment Facility (ESAF), which later translated into a poverty reduction growth facility (PRGF), under which it has had a mixed but overall positive performance. The main area of success has been the liberalisation of the external sector. The maximum tariff was lowered from 90% in 1998 to 18%, and the number of non-zero tariff bands to three. The introduction of foreign currency deposit accounts by some commercial banks in February will further facilitate international trade. At the same time, the government has failed to meet a number of qualitative and quantitative performance benchmarks. Relations became particularly tricky after the government's expropriation of the GGC. Nonetheless, the IMF and World Bank recommended The Gambia for enhanced HIPC debt relief after what they deemed was a satisfactory reform track record of 2½ years. Debt relief and donor assistance will encourage reform in the mediumterm.

## ■ Financial Sector

The banking system, through privatisation and the opening up of the sector to new domestic and foreign entrants since the mid 1980s, is almost

totally private and majority foreign-owned. Normally, high foreign and private ownership limits the government's contingent liability, but in the case of The Gambia this is less clear cut. There is already a precedent of the government taking over the management of Meridien Bank (an international bank), owing to the collapse of the parent bank in 1995. It was sold to new owners in 1999 as Trust Bank. One small bank, Continent Bank with total deposits worth GMD70m (USD4m) and assets worth GMD42m was put under central bank management in January 2002 and the cost of its recapitalisation or liquidation will be borne by the government. This highlights the importance of strengthening banking supervision. Nonetheless, with total net assets of around 30% of GDP at the end of 2001, the overall banking sector is small and this helps mitigate the potential cost to the government. The two largest banks – Standard Chartered (70% foreign owned, 100% private) and Trust Bank (30% foreign, 90% private) – which together account for 80% of the banking sector's deposits and 83% of assets – are relatively sound.

Although banking regulations are only just being brought up to international standards<sup>3</sup>, banking supervision has improved. Starting in 2002 there is at least one on-site supervision every year for the seven banks. In addition, non-performing loans, which had become a major problem (mainly as a result of the agriculture sector) have fallen from 27% of all outstanding bank loans in 1997 to 7.3% in June 2002. Provisioning has also improved to 90% of required provisions from 46% in 1997. Banks are also relatively liquid and the average capital adequacy ratio at 27% in June 2002 is much higher than the minimum required. The Central Bank is responsible for the supervision of a small insurance sector with assets of around GMD66m or 1% of GDP at the end of 2001 for 11 insurance companies and a growing micro-lending and rural finance sector.

## Key Facts: Financial System

M2 (% of GDP)	39
NPL Ratio (%)	7
Capital Adequacy Ratio (%)	27
Public Ownership, % of Assets	almost zero
Foreign Ownership, % of Assets	65

In common with many other developing countries, a lack of bankable projects, reflecting a whole host

<sup>2</sup> Prior to that the government divested 22 public enterprises, starting in the late 1980s.

<sup>3</sup> For example the Financial Institutions Bill and Insurance Bill are currently being revamped.

of structural problems, such as a weak legal system, lack of collateral, etc constrain bank lending to the private sector. In addition, high treasury bill yields crowd out private lending. Most bank lending in The Gambia is undertaken by trade businesses and public enterprises. Nonetheless, it is estimated that a large portion of transactions in the trading sector take place outside the banking system, owing to the informal nature of the re-exports sector. As of February 2002, foreign currency accounts can be opened up in three of the banks. The government is hoping that this will lead to increased usage of banking facilities, less capital flight and encourage the development of The Gambia as a regional banking centre for people involved in the re-export sector.

## ■ Public Finance

After a sharp deterioration in public finances between 1994 and 1997 they have broadly improved, following the re-launch in 1998 of reforms under an IMF programme and the return of donor budgetary assistance. While the overall trend has been towards improved fiscal consolidation, operational and structural weaknesses have impeded a sustained improvement in public finances and domestic debt has continued to rise.

Overspending has been a major problem as an already weak expenditure control situation has been complicated by non-budgeted-for expenditure. Revenue reforms have been generally more successful and according to the IMF, The Gambia's 'tax effort' is high by regional standards: tax revenue is around 16% of GDP. However, customs revenue, which accounts for between 43%-60% of revenue, has been adversely affected by tariff reductions and is vulnerable to external factors, while tax arrears owed by public enterprises continue to undermine revenue performance.

Fiscal deficits (including grants) narrowed from almost 10% of GDP in 1995 and 1996 to a low of 1.4% of GDP in 2000. However, a one-off payment for power generators and an increase in non-budgeted-for expenditure related to the presidential and legislative elections threw expenditure off course last year. On the revenue side, a customs revenue shortfall and an increase in public enterprise arrears, resulted in below target revenues. These factors led to a budget deficit including grants in excess of 7% of GDP in 2001.

Overspending continued in the first half of this year. Though the government has since tightened expenditure by limiting obligatory expenditure to pensions, public debt and defence, and by shifting department spending to a cash budget system,

revenue is also likely to be hit by the border problems with Senegal between April and July this year. The overall deficit (excluding grants) in 2002 was revised upwards by 1% point to 5% of GDP, but could come out higher.

Budgetary spending in 2003-2005 will be driven by the PRSP (where the priority areas are education, health and agriculture). At the same time fiscal policy will be aimed at improving fiscal discipline and reducing domestic debt. Overall improvements in revenue are projected to be moderate and the government expects grants including HIPC debt relief to cover most of the increases in expenditure. A round table conference in September came up with the PRSP funding. Deficits are projected to be relatively low in the medium term – at around 4% of GDP excluding grants. The government aims to start paying down its domestic debt in 2003, relying solely on external concessional financing for deficit financing in the medium term.

## Public Finances: Sources and Uses

Local Currency	2001	2002f
<b>Uses</b>	<b>737</b>	<b>404</b>
Budget Balance	-438	-163
Amortisation	298	241
Domestic	41	41
External	257	200
<b>Sources</b>	<b>737</b>	<b>404</b>
Gross Borrowing	630	239
Domestic	397	3
External	234	236
Privatisation	0	0
Other	107	165

Source: Department of State for Finance and Economic Affairs, IMF, FitchRatings estimates and forecasts

Medium-term tax revenue reforms will be mainly geared towards tax administration, with the main initiative being the transformation of all revenue generating components to a revenue authority. The government will also look for ways to diversify the tax base towards domestic taxes and away from customs taxes, which are likely to continue to be affected by border problems with Senegal, which impede re-exports trade. There is also the potential threat in the medium term of Senegal reducing its tariffs further (resulting from the further liberalisation of trade amongst CFA zone countries). More generally, customs revenues are affected by fluctuations in commodity prices. There is also the problem of public sector tax arrears and the government's non-payment of services, which need to be netted out and hence prevented from being built up again.



The main short-term priority of tax reforms is the maintenance of strict expenditure controls, particularly on non-budgeted-for expenditure. In the medium term the government will need to implement broader budgetary reforms to enhance the transparency and improve the soundness of public finances so that it can better support social sector priorities under the PRSP. We can expect to see continued slippage in the area of expenditure control and other reforms are likely to proceed more slowly than planned. Nonetheless with two major one-offs – the elections and compensation to Alimenta – out of the way, the overall outlook for fiscal consolidation is likely to be positive. PRSP and the HIPC initiative will also support the budget.

With the suspension of most donor aid in 1994 and a deterioration in the fiscal balance in the mid-1990s, the government financed the deficit through heavy domestic borrowing. As a result, domestic debt rose from 10.4% of GDP in 1994 to 25.9% of GDP in 1998. Despite a commitment to reducing domestic debt since 1998, fiscal slippage has led to a continued rise in the domestic debt to 33½% of GDP at the end of 2001. While the overall level is not particularly high, it has risen very fast. With the T-bills rate<sup>4</sup> currently as high as 17% (10% real), interest costs on domestic debt absorb around 20% of government revenue, leaving less resources for much needed social and other spending.

The main buyers of the T-bills are social security funds and banks, and in the case of the latter, this also contributes to the crowding out of private investment. The issuer of T-bills, both for the government's borrowing requirement and for liquidity management, is, however, the Central Bank. This creates a problem as the Ministry of Finance does not have sufficient control over the number of treasury bills issued even though it pays the interest on all the treasury bills. From a credit rating perspective this is negative for the local currency rating.

External borrowing by public enterprises is guaranteed by the government, presenting a contingent liability. However, most of the borrowing is on concessional terms (on-lent by the government) and so far public enterprises have been able to honour their obligations.

<sup>4</sup> Interest rates are not market determined but are instead set by the Central Bank.

## ■ Monetary & Exchange Rate Policy

The main objective of monetary policy is to achieve price stability. The exchange rate has been freely floating since 1986 and the Central Bank intervenes to smooth fluctuations and to meet its external reserves' objective, which is five months of import cover. A parallel market exists, although the differential between the official exchange rate and the unofficial exchange rate has been normally very small, and mainly reflects greater flexibility in terms of access to the parallel markets and the large degree of re-export trade in the informal sector, where many people do not have bank accounts.

The Central Bank of The Gambia (CBG) has used indirect instruments for monetary policy since 1990 – chiefly treasury bills and Central Bank bills with three and six month maturities. Treasury bills are also issued by the Central Bank to meet the government's borrowing requirement. Throughout most of the 1990s high real interest rates on treasury bills kept inflation low and the exchange rate relatively stable. Since 1998, the Central Bank has kept liquidity in the domestic system consistent with a sustainable balance of payments position (and external reserves position) according to targets agreed with the IMF. There is a quarterly cap on net domestic credit in order to discourage excessive government borrowing – but this benchmark has been breached during the past two years. As a result of rising domestic debt, real interest rates have remained high.

Since the beginning of 2000 the dalasi has depreciated against the USD by 41% in nominal terms, reflecting balance of payments pressures, stemming from lower tourism and official receipts. Inflation, which had fallen to 0.9% in 2000, has since risen reflecting the depreciation of the exchange rate and excessive government borrowing. Nevertheless, estimated at around 6% in 2002, inflation is relatively low. High aid flows during 2003-2005 should support the dalasi and help bring down inflation.

The Gambia is one of the five<sup>5</sup> anglophone members of the Economic Community of West African States (ECOWAS) that pledged to set up a second monetary union known as the West African Monetary Zone (WAMZ) by January 2003. The existing national central banks will be under the control and direction of a newly created West African Central Bank. These plans are now running a bit behind schedule and it may possibly start off

<sup>5</sup> Others include Ghana, Guinea, Nigeria, Sierra Leone – Cape Verde and Liberia, which are on observer status.

with fewer than the five members. However, with the possible exception of the fiscal deficit which has to fall to 4% of GDP at the end of 2003, The Gambia should quite easily meet most of the convergence criteria<sup>6</sup>. The members hope to derive benefits in terms of greater macroeconomic stability, lower transaction costs, thereby facilitating trade and overall integration. Ultimately, the WAMZ is aiming to merge with the 52-year old West African Economic and Monetary Union (WAEMU) for francophone countries in the region. But this is likely to be some way off.

## ■ External Finance

Merchandise imports and exports are dominated by the re-exports business. From within the domestic economy the two main merchandise exports are groundnuts and fish, which account for just 10% of total exports. Owing to The Gambia's limited production base, most consumer goods including basic food, are imported. Thus the deficit on trade is normally very large, although it does fluctuate because of the re-exports sector which is periodically affected by a tightening of border controls by Senegal. In the future, this sector may be threatened by the implementation of more favourable duties in other countries because of further progress on trade agreements in the CFA zone. Most of the trade is in the informal sector so that re-exports figures are almost certainly underestimated, although imports are more accurate.

The merchandise trade balance has in the past been partially offset by a relatively strong services and current transfers balance owing to tourism receipts, remittances and official transfers. Over the past two years, tourism receipts have dropped and are expected to pick up only slowly. At the same time, private remittances and official transfers have increased. Thus the current account deficit (including official transfers) has been moderate, rising to 6.7% of GDP in 2001 (largely because of the one-off importation of three generators) from the 3%-4% range during 1998-2000.

Certain reforms to the external sector for example, a newly-created Tourism Promotion Agency, the establishment of free trade zones for export investment and the possibility of gaining membership to the US AGOA trade initiative, following the satisfactory conduct of elections and improved relations with the US point to a gradual

increase in non re-exports and services receipts. Re-exports are likely to benefit from the introduction of foreign currency accounts in The Gambia's banks. Remittances will continue to grow. Following the donor conference in September where The Gambia was pledged to receive USD115m over the next three years, a sharp rise in official transfers in 2003 is expected. These will offset growing imports related to the PRSP and their transportation. The current account deficit is expected to moderate to 3%-5% of GDP in 2002-2003.

The capital account will benefit from enhanced HIPC debt relief where amortisation payments are projected to fall from around USD11m in 2000 and 2001 to USD4m in 2003. The Gambia has good access to concessional borrowing and together with FDI inflows (to the tourism and exports processing sectors) should comfortably cover the financing gap in 2003.

## External Finances: Sources and Uses

USD billions	2001	2002f	2003f
<b>Uses</b>	<b>37</b>	<b>26</b>	<b>15</b>
Current Account Balance	26	15	11
Amortisation	11	11	4
<b>Sources</b>	<b>37</b>	<b>26</b>	<b>15</b>
Gross Borrowing	30	15	7
Net FDI	4	2	4
Net lending abroad	5	5	5
Other capital net	5	5	5
Change in reserves (-ve=increase)	-7	-1	-6

Source: IMF, FitchRatings estimates and forecasts

Based on a debt sustainability analysis (DSA), which put the NPV of debt to exports of goods and services (CXR) minus re-exports trade<sup>7</sup> at 206% at end-1999, assuming the full application of traditional<sup>8</sup> debt relief, The Gambia qualified for debt relief under the enhanced HIPC initiative in December 2000, also known as the decision point. According to the cut-off criterion of 150% of CXR, The Gambia will be eligible for a total of USD67m NPV debt relief when it reaches a 'floating' completion point – estimated for end-2003. In the meantime, The Gambia shall receive interim debt relief from the World Bank, IMF, AfDB and the

<sup>7</sup> The World Bank and IMF deducted this on the basis that this trade provides little value-added to the economy.

<sup>8</sup> Naples terms stock of debt reduction (67 per cent NPV reduction on eligible debt) and a topping up of all previously rescheduled debt.

<sup>6</sup> These are less than 5% inflation, reserves import cover of three months and central bank financing of the deficit limited to 10% of previous year's tax revenue.

Paris Club creditors, accounting for 16% of total debt relief.

From a credit rating perspective the fact that The Gambia was not in arrears in the lead up to voluntary debt rescheduling and the whole process was spearheaded by its main creditor – the World Bank – helps mitigate the negative perception of having to seek debt relief. Qualification for debt relief was also premised on a 2½ year reform track record, deemed satisfactory by the IMF and the World Bank. However, in order to reach the floating completion point, the government has to implement a number of reforms, the most important of which are:

- The completion and satisfactory implementation for one year of a fully participatory PRSP.
- Bring to point of sale the two major public groundnut processing plants in the country, and establish a functional multi-sector regulatory agency.
- Issue public annual reports on overall budget execution and semi-annual reports on the use of interim HIPC debt relief.

Although the government's commitment to reforms is relatively strong, and obtaining debt relief will in itself motivate the adherence to the agreed conditions, The Gambia's tendency of policy slippage, owing to capacity constraints and sometimes for reasons within its control, means that a completion point date of end-2003 (already delayed by one year) cannot be guaranteed. While some delay is likely, the implementation of these reforms is crucial to maintain the current rating level which factors in HIPC debt relief.

## External Debt Ratios - 2003

	B/B- median	The Gambia
GXD% of CXR	176	134
GXD% of GDP	60	127
NXD% of CXR	113	97
NXD % of GDP	36	90

Assuming that The Gambia reaches its completion point, the nominal gross external debt (GXD):CXR ratio should fall to 134% in 2003 from around 180% in 2000-2001. The net external debt (NXD):CXR ratio should fall from 140% in 2000-2001 to 97% in 2003. This will be more or less in line with the rating median for 'B/B-' credits. According to the IMF, on a NPV basis (which takes into the concessional nature of its debt) The Gambia's public external debt ratios after enhanced

HIPC debt relief at the end of 1999 would have been much more comfortable with GXD estimated at 41% of GDP. There is also a possibility that remaining bilateral debt could be forgiven and thus the debt burden could actually be lower by USD13m in NPV terms on the completion point.

As a result of interim HIPC debt relief and because much of the debt is concessional, external debt service fell to 5.5% in 2001 compared with 7% in 2000 and will fall to 3% upon the completion point. External liquidity (liquid external assets/short-term external obligations) for The Gambia is fairly strong at an average of around 300% over the past five years, because of fairly large reserves. With the large increase in donor aid we estimate a strengthening of liquidity over the next three years.

## The Gambia's Debt Relief

### Multilateral organisations

IDA, the largest creditor accounting for NPV USD22.5m in HIPC assistance, will provide a 50% reduction of debt service from the decision point, which is not revocable at the completion point until 2012. AfDB and IMF will provide assistance from the decision point onwards. Other multilateral organisations will provide relief at the completion point.

### Paris Club

Provided on Cologne Terms (90% NPV reduction) of debt service, following the decision point and a stock-of-debt reduction at the completion point.

### Non Paris Club official creditors

At least comparable treatment to the Paris Club group of creditors would be provided by non-Paris Club official bilateral creditors at the completion point.

Note: The Gambia had no commercial debt. Under the burden sharing principle commercial creditors are expected to provide debt relief on comparable terms to non-Paris Club official creditors.

## Fiscal Accounts Summary\*

% of GDP	1997	1998	1999	2000	2001e	2002f	2003f
<b>Revenue &amp; grants (excl. priv'n)</b>	<b>20.4</b>	<b>20.5</b>	<b>19.2</b>	<b>20.7</b>	<b>18.4</b>	<b>21.5</b>	<b>22.2</b>
o/w import duties	11.4	11.2	10.0	10.6	8.6	9.7	10.0
grants	1.3	2.0	1.3	2.3	2.2	4.0	4.3
<b>Expenditure &amp; net lending</b>	<b>26.9</b>	<b>23.0</b>	<b>22.7</b>	<b>22.1</b>	<b>25.5</b>	<b>23.8</b>	<b>26.0</b>
<b>Primary balance (excl. interest)</b>	<b>-1.3</b>	<b>2.9</b>	<b>1.5</b>	<b>3.5</b>	<b>-2.2</b>	<b>2.8</b>	<b>1.2</b>
<b>Overall balance</b>	<b>-6.5</b>	<b>-2.4</b>	<b>-3.5</b>	<b>-1.4</b>	<b>-7.2</b>	<b>-2.3</b>	<b>-3.8</b>
<b>Financing:</b>							
<b>Domestic</b>	<b>1.4</b>	<b>1.8</b>	<b>3.6</b>	<b>3.1</b>	<b>9.0</b>	<b>1.6</b>	<b>-1.0</b>
Banks	0.6	-0.4	1.4	0.8	8.3	2.2	-1.8
Non-banks	0.9	1.9	1.9	2.6	1.1	-0.5	0.8
Arrears	0.0	0.3	0.3	-0.4	-0.4	-0.1	0.0
<b>External, net</b>	<b>3.9</b>	<b>1.2</b>	<b>0.6</b>	<b>-0.8</b>	<b>-0.4</b>	<b>0.8</b>	<b>2.6</b>
Privatisation	0.0	0.0	0.0	0.4	0.0	0.0	0.0
Unidentified	1.1	-0.5	-0.7	-1.3	-2.5	0.0	2.2
<b>Public debt*</b>							
Domestic	22.4	25.6	27.0	31.3	33.4	28.9	26.3
o/w Treasury bills	19.8	22.8	24.4	29.0	31.3	27.1	24.7
External	101.3	106.4	101.0	117.4	128.3	133.2	100.0
<i>Public debt (% of revenue)</i>	<i>606.5</i>	<i>642.6</i>	<i>667.2</i>	<i>717.9</i>	<i>879.6</i>	<i>754.4</i>	<i>568.7</i>
<b>memo:</b>							
<i>interest service (% of revenue)</i>	<i>25.2</i>	<i>25.7</i>	<i>26.3</i>	<i>23.7</i>	<i>26.7</i>	<i>24.0</i>	<i>22.5</i>

\* All figures refer to the central government

Source: Department of State for Finance and Economic Affairs, IMF, FitchRatings estimates and forecasts

## External debt & liquidity

USDmn	1997	1998	1999	2000	2001e	2002f	2003f
<b>Gross external debt</b>	<b>450</b>	<b>487</b>	<b>501</b>	<b>505</b>	<b>523</b>	<b>527</b>	<b>444</b>
% of GDP	109.8	115.8	116.0	119.7	133.9	140.7	124.0
% of CXR	162.0	162.3	176.7	186.3	179.7	172.5	133.7
<b>By maturity:</b>							
Medium- and long-term	437	472	479	477	498	502	419
Short-term	13	15	22	27	25	25	25
% total debt	2.9	3.1	4.4	5.4	4.8	4.7	5.6
<b>By debtor:</b>							
Public sector	412	444	442	443	456	458	369
Non-bank private sector	23	30	42	52	56	60	65
Banks	15	13	17	9	10	9	10
<b>By creditor:</b>							
Multilateral	326	347	346	341			
Bilateral	76	86	84	84			
Commercial banks	45	53	57	60			
Debt securities	0	0	0	0			
Other	3	1	14	20			
<b>Gross external assets *</b>	<b>107</b>	<b>113</b>	<b>122</b>	<b>119</b>	<b>115</b>	<b>115</b>	<b>121</b>
International reserves, incl. gold	96	106	111	109	106	107	113
Deposit money banks' foreign assets	11	7	11	9	9	8	8
<b>Net external debt</b>	<b>343</b>	<b>374</b>	<b>379</b>	<b>386</b>	<b>408</b>	<b>412</b>	<b>323</b>
% of GDP	83.7	88.9	87.8	91.5	104.4	110.0	90.2
% of CXR	123.5	124.7	133.6	142.5	140.1	134.7	97.2
<b>Debt service (principal &amp; interest)</b>	<b>25</b>	<b>20</b>	<b>17</b>	<b>20</b>	<b>16</b>	<b>16</b>	<b>10</b>
Debt service (% of CXR)	8.9	6.8	5.9	7.3	5.5	5.3	2.9
Interest service (% of CXR)	4.1	1.8	1.9	2.3	1.6	1.7	1.7
<b>Liquidity ratio (%)</b>	<b>223.6</b>	<b>317.6</b>	<b>353.4</b>	<b>291.6</b>	<b>272.8</b>	<b>280.2</b>	<b>333.4</b>
excl. banks' foreign assets	216.4	285.8	333.0	265.5	251.6	257.9	310.3

\* non-bank private sector external assets are not taken into account

Source: IMF, World Bank, BIS, FitchRatings estimates and forecasts

## Balance of Payments

USDmn	1997	1998	1999	2000	2001e	2002f	2003f
<b>Current account balance</b>	<b>-24</b>	<b>-11</b>	<b>-17</b>	<b>-19</b>	<b>-26</b>	<b>-15</b>	<b>-11</b>
% of GDP	-5.7	-2.7	-4.0	-4.4	-6.6	-4.1	-3.1
% of CXR	-8.5	-3.8	-6.0	-6.9	-8.8	-5.0	-3.4
<b>Trade balance</b>	<b>-87</b>	<b>-77</b>	<b>-73</b>	<b>-66</b>	<b>-78</b>	<b>-72</b>	<b>-83</b>
Exports, fob	120	130	120	126	140	149	150
(annual % change)	0.7	8.7	-7.6	5.2	11.1	6.3	0.5
o/w groundnuts	5	13	10	13	14	15	16
re-exports	104	109	104	105	117	124	124
Imports, fob	207	207	193	192	219	221	233
(annual % change)	-4.6	0.1	-6.7	-0.5	13.7	0.9	5.6
<b>Services, net</b>	<b>35</b>	<b>28</b>	<b>17</b>	<b>1</b>	<b>0</b>	<b>4</b>	<b>-1</b>
o/w travel, credit	73	81	74	57	60	63	66
<b>Income, net</b>	<b>-8</b>	<b>-2</b>	<b>-2</b>	<b>-2</b>	<b>-1</b>	<b>-2</b>	<b>-2</b>
Income, credit	109	120	112	89	94	99	104
Income, debit	11	5	5	6	5	5	6
o/w: interest payments	11	5	5	6	5	5	6
<b>Current transfers, net</b>	<b>37</b>	<b>40</b>	<b>42</b>	<b>49</b>	<b>54</b>	<b>55</b>	<b>75</b>
<b>Non-debt creating flows, net</b>	<b>12</b>	<b>9</b>	<b>6</b>	<b>2</b>	<b>4</b>	<b>2</b>	<b>4</b>
Direct investment, net	12	9	6	2	4	2	4
Portfolio equity investment, net	0	0	0	0	0	0	0
<b>External borrowing, net</b>	<b>10</b>	<b>2</b>	<b>4</b>	<b>-2</b>	<b>18</b>	<b>5</b>	<b>3</b>
Portfolio debt securities, liabilities	0	0	0	0	0	0	0
Other investment liabilities	17	3	4	-7	12	5	3
Use of IMF credits	-7	-1	0	5	6	0	0
<b>Net lending abroad</b>	<b>10</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>
<b>Capital nes, net</b>	<b>6</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>
<b>Net errors and omissions</b>	<b>-14</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Overall balance = chg in reserves (-=incr)</b>	<b>0</b>	<b>-10</b>	<b>-3</b>	<b>8</b>	<b>-7</b>	<b>-1</b>	<b>-6</b>
<b>memo:</b>							
Gross borrowing (incl. short-term)	46	30	31	34	57	40	32
Gross external financing requirement	37	27	28	32	37	26	15
Stock of International reserves, excl. gold	96	106	111	109	106	107	113

Source: IMF, FitchRatings estimates and forecasts

## Repayment Schedule on Medium- and Long-Term Public Debt

USDmn	2000	2001	2002	2003	2004	2005	2006
<b>Amortisation</b>							
Before debt relief	13.7	16.5	16.2	15.1	16.1	16.6	18.6
After Enhanced HIPC treatment	13.6	11.3	10.8	3.9	4.7	5.5	8.1
<b>Interest</b>							
Before debt relief	6.2	6.2	7.0	7.4	7.6	7.5	7.4
After Enhanced HIPC treatment	6.1	4.8	5.3	5.7	6.3	6.4	6.5
<b>Total</b>							
Before debt relief	<b>19.9</b>	<b>22.7</b>	<b>23.2</b>	<b>22.5</b>	<b>23.7</b>	<b>24.1</b>	<b>26.0</b>
After Enhanced HIPC treatment	<b>19.7</b>	<b>16.1</b>	<b>16.1</b>	<b>9.6</b>	<b>11.0</b>	<b>11.9</b>	<b>14.6</b>

Source: IMF, FitchRatings estimates

Copyright © 2002 by Fitch, Inc. and Fitch Ratings, Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. All of the information contained herein is based on information obtained from issuers, other obligors, underwriters, and other sources Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified, and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed, suspended, or withdrawn at any time for any reason at the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services Act of 1986 of Great Britain, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.